

AGENDA — June 29, 1999 Business Taxes Committee Meeting
Regulation 5200, Annotations, and Regulation 1705, Relief from Liability

Action 1 – Consent Regulation 5200 Regulation 1705	Adopt proposed language as agreed upon by staff and industry.
Action 2 – “Definition of an Annotation” Regulation 5200	Adopt either: 1) Industry B’s proposed language (Attachment 1, page 1); or 2) Staff and Industry A’s proposed language (Attachment 1, page 1)
Action 3 – “Use of Annotations” Regulation 5200	Adopt either: 1) Industry B’s proposed language (Attachment 1, pages 3-5); or 2) Staff and Industry A’s proposed language (Attachment 1, page 3)
Action 4 – Authorization to Publish	Direct the publication of the proposed Regulation 5200 and proposed amendments to Regulation 1705 as adopted in the above actions.

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Regulation 5200, Annotations, and Regulation 1705, Relief from Liability

ACTION 1 – Consent Items

Item	Comments
1. Attachment 1. Pages 2-3. “Definitions”	Accept proposed language agreed upon by staff and industry.
2. Attachment 1. Pages 5-6. “Elements of Legal Rulings of Counsel”	Accept proposed language agreed upon by staff and industry.
3. Attachment 1. Pages 6-7. “Publication of Annotations”	Accept proposed language agreed upon by staff and industry.
4. Attachment 1. Pages 7-8. “Depublication of Annotations”	Accept proposed language agreed upon by staff and industry.
5. Attachment 1. Page 8. “Copies of Legal Rulings of Counsel”	Accept proposed language agreed upon by staff and industry.
6. Attachment 2. Pages 1-6. “Regulation 1705”	Accept proposed language agreed upon by staff and industry.

AGENDA — June 29, 1999 Business Taxes Committee Meeting

Regulation 5200, Annotations, and Regulation 1705, Relief from Liability

Action Item	Staff and Industry A's Proposed Language	Industry B's Proposed Regulatory Language
ACTION 2, "Definition of an Annotation"		
Attachment 1, Page 1	<p>(a) Definitions For purposes of this regulation, the following definitions shall apply:</p> <p>(1) "Annotations" that are published in either the Business Taxes Law Guide or the Property Taxes Law Guide are summaries of the conclusions reached in selected legal rulings of counsel.</p>	<p>(a) Definitions For purposes of this regulation, the following definitions shall apply:</p> <p>(1) "Annotations" are mere summaries of conclusions reached in legal rulings of counsel that are published as annotations in either the Business Taxes Law Guide or the Property Taxes Law Guide. An annotation is an agency's interpretation of the meaning and legal effect of a statute or regulation.</p>
ACTION 3, "Use of Annotations"		
Attachment 1, Pages 3-5	<p>(b) Use of Annotations</p> <p>(1) Annotations provide notice of the existence of and conclusions reached in selected legal rulings of counsel regarding the application of the statutory law, regulatory law, or judicial opinions to a particular factual circumstance.</p> <p>(2) Annotations are a research tool to locate selected legal rulings of counsel.</p>	<p>(b) Use of Annotations</p> <p>Annotations are intended to provide guidance to both taxpayers and Board staff regarding the interpretation of statutes and regulations and are not binding on the Board itself, taxpayers, or local government officials. The binding power of an agency's interpretation of a statute or regulation is contextual: Its power to persuade is both circumstantial and</p>

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Action Item	Staff and Industry A's Proposed Language	Industry B's Proposed Regulatory Language
	<p>(3) Annotations and the legal rulings of counsel they summarize are not regulations, not considered authority for the application of law, and are not binding upon taxpayers, members of local government agencies, board staff, or the Board.</p>	<p>dependent on the presence or absence of factors that support the merit of the interpretation. The ultimate interpretation of a statute is an exercise of the judicial power. Where the meaning and legal effect of a statute is the issue, an agency's interpretation is one among several tools available to the court. Depending on the context, an annotation may be helpful, enlightening, even convincing. It may sometimes be of little worth. The weight of an annotation in a particular case will depend upon the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control.</p> <p>The taxpayer has a right to know the law and an agency's interpretation of the statutes and regulations. In order to assist taxpayers, who are seeking to be in conformity and compliance with the law, and request to know what the applicable law and its interpretations are, Board staff and auditors will provide the taxpayer with</p>

AGENDA — June 29, 1999 Business Taxes Committee Meeting
Regulation 5200, Annotations, and Regulation 1705, Relief from Liability

Action Item	Staff and Industry A's Proposed Language	Industry B's Proposed Regulatory Language
		identification of the applicable statutes, regulations and annotations related to transactions the taxpayer is seeking to be in conformity and compliance. When providing taxpayers with the reference of an annotation or a written copy of an annotation, such disclosure must be accompanied with an explanation of what an annotation is and the description of the proper use of an annotation.

ACTION 4, Authorization to Publish
(whichever language is approved)

FORMAL ISSUE PAPER

Issue Paper Number 99-028



BOARD OF EQUALIZATION
KEY AGENCY ISSUE

STATE OF CALIFORNIA
BOARD OF EQUALIZATION

- ☐ Board Meeting
- ☒ Business Taxes Committee
- ☐ Customer Services Committee
- ☐ Legislative Committee
- ☐ Property Tax Committee
- ☐ Technology & Administration Committee
- ☐ Other

PROPOSAL TO CLARIFY THE USE OF ANNOTATIONS

I. Issue

Should formal policy and procedures be set forth in the form of a Regulation or Operations Memorandum to address the publication and proper use of annotations?

II. Staff Recommendation

Adopt proposed regulatory language as agreed upon by staff and Industry A¹ and amend Regulation 1705, Relief from Liability, as agreed upon by staff and Industry.

III. Other Alternative(s) Considered

Alternative 1:

Adopt regulatory language as proposed by Industry B² to define the term "Annotation" and set forth the proper use of annotations based upon the California Supreme Court's interpretation of the treatment of annotations.

¹ Cal-Tax, Ernst & Young LLP, and Bewley, Lassleben & Miller, LLP.

² Mr. Mark Prescott, Chief Financial Officer of Hunter Mold.

IV. Background

In October 1998, a Board Member submitted proposed regulation, *Legal Rulings of Counsel*, for staff's review. The Board Member believes that many of the documents supporting the annotations appear to lack the thoroughness necessary to comport with the standard set out in *Yamaha Corporation of America v. State Board of Equalization* (1998) 19 Cal.4th 1. As a result, the weight that may be given to an annotation varies greatly depending on the specific backup document at issue. Accordingly, the Board Member believes it is imperative that a regulation be adopted detailing the minimal elements required of annotations and their backup documents to ensure that all published annotations meet the Yamaha standard.

On November 30, 1998, staff responded to the Board Member's proposed regulation providing suggested revisions. The Board Member's proposed regulation along with staff's suggested revisions are the basis of staff's initially proposed Operations Memorandum, *Annotations*, and proposed revisions to Regulation 1705, *Relief from Penalty*, which were distributed to interested parties on April 5, 1999.

An "interested parties" meeting was held on April 12, 1999, to discuss staff's initial proposal. At that meeting, staff was advised of the reasons a regulation is needed, which include inappropriate references to annotations at Board hearings, annotation back-up documents consisting of no more than one paragraph, illegible back-up documents, and annotation back-up documents not considered to be a legal ruling of counsel. It was pointed out that an annotation needs a good analysis of facts and a conclusion. Minor corrections to staff's proposed revisions to Regulation 1705 were also suggested. The discussion centered primarily on Business Taxes annotations. Property Taxes annotations are generally of more recent origin, and all have legible and available back-up documents.

In response to staff's initial proposal, California's Taxpayers' Association (Cal-Tax) submitted proposed regulatory language to be inserted in the Board's practice and procedures (Rules of Practice) regulations. Cal-Tax also submitted proposed language to be incorporated into Regulation 1705. In addition to Cal-Tax, comments were received from representatives of Ernst & Young LLP and Bewley, Lassleben & Miller, LLP.

The *Revised Discussion for Issue Paper on Annotations*, staff's proposed draft of Operations Memorandum, *Annotations*, a draft of proposed revisions to Regulation 1705, *Relief from Penalty*, and matrices comparing staff's and industry's proposals were mailed to interested parties on May 20, 1999. To provide interested parties an additional opportunity to discuss the proposals and present any suggested changes or comments, a second "interested parties" meeting was held on June 1, 1999. At that meeting, industry responded to staff's interpretation of *Yamaha*, the issue of setting forth the publication and correct use of annotations in an Operations Memorandum or Regulation, and staff's proposal addressing other industry concerns.

In response to staff's revised proposal, Cal-Tax submitted a discussion of Regulation versus Operations Memorandum, existing annotations/back-up documents, availability of annotation back-up documents, and challenging annotations. Each of Cal-Tax's proposals are discussed below. In addition to Cal-Tax, comments were received from Mr. Mark Prescott, Chief Financial Officer of Hunter Mold.

Discussion – Annotation History

Annotations have been published by the Board for more than forty (40) years. Annotations are synopses of legal opinions published in the Business Taxes Law Guide (includes Sales and Use Tax and Special Taxes) and the Property Taxes Law Guide. Annotations are used by both Board staff and the public as guidance in the interpretation of statutes and Board regulations. Property Taxes annotations serve as guidance to county assessors, local boards of equalization, the public, and Board staff in the administration and application of the Property Tax Laws.

The Business Taxes annotation project was coordinated by the Legal Division until May 1991 when the responsibility for updating and revising the Sales and Use Tax Annotations was transferred to the Sales and Use Tax Department, Audit Evaluation and Planning Section. The Audit Evaluation and Planning Section worked with the Legal Division to eliminate obsolete and incorrect annotations, reduce the backlog of unannotated opinions and expand the length of brief annotations to make them more informative. As part of this project, the Audit Evaluation and Planning Section assigned sections of the annotations to district offices for review and solicited their recommendations and suggestions. Additionally, the district offices were asked to provide letters to the Audit Evaluation and Planning Section which they considered to be valuable guidance and worth annotating.

Further impetus for annotations occurred in 1992 when *State Board of Equalization v. Superior Court* (1992) 10 Cal.App.4th 1177 was decided. This case involved the disclosure of documents pursuant to a California Records Act request (Government Code section 6250 et seq.). To address the public access issues raised by the court's decision, the Board initiated the Improving Public Access to Information Project, of which the Historical Annotation Project is part.

The Business Taxes Historical Annotation Project commenced in November 1993 to provide greater access to what the court regarded as the Board's "working law." The objective of the Historical Annotation Project was to update and expand the Business Taxes Law Guide Annotations and to eliminate district office opinion files/libraries. Over thirty-five thousand (35,000) letters were reviewed by staff, including legal opinion letters from the Legal Division (1/1/88 to 10/31/93) and Decision and Recommendations from the Appeals Section (1/1/90 to 10/31/93). From the thirty-five thousand (35,000) letters reviewed, approximately four thousand (4,000) new sales and use tax annotations were added to the Business Taxes Law Guide. The Historical Annotation Project was concluded in June 1997.

The Business Taxes Annotation Project is ongoing. Appropriate legal opinions are now annotated on a current basis, as drafted by the Audit Evaluation and Planning Section and approved by the Legal Division. As of the Business Taxes Law Guide M99-1 edition, there were six thousand eight hundred eighteen (6,818) sales and use tax annotations.

The Property Taxes Annotation Project was coordinated by the Legal Division until February 1997 when the responsibility for updating and revising the property taxes annotations was transferred to the Property Taxes Department's Policy, Planning, and Standards Division. The Property Taxes Historical Annotation Project commenced in February 1995. As part of the Property Taxes Historical Annotation Project, staff reviewed over fifteen thousand (15,000) letters dated between 1977 and 1995. From those fifteen thousand (15,000) letters, approximately three hundred fifty (350) new annotations were added to the Property Taxes Law Guide. The Property Taxes Historical Annotation Project was concluded in August 1998. Appropriate legal opinions are now annotated on an ongoing basis. As of the Property Taxes Law Guide M99-1 edition, there were one thousand three hundred sixty five (1,365) property taxes annotations.

The Special Taxes Annotation Project is coordinated by the Special Tax Department, Program Planning and Evaluation Division. As of the Business Taxes Law Guide M99-1 edition, there were four hundred forty four (444) special taxes annotations.

Yamaha v. State Board of Equalization – Discussion

The court in *Yamaha Corporation of America v. State Board of Equalization* (1998) 19 Cal.4th 1, held that the Board's annotations were not entitled to the same weight as a quasi-legislative rule. The Court, on page 7 of the opinion, states: "*An agency interpretation of the meaning and legal effect of a statute is entitled to consideration and respect by the courts; however, unlike quasi-legislative regulations ... the binding power of an agency's interpretation of a statute or regulation is contextual: Its power to persuade is both circumstantial and dependent on the presence or absence of factors that support the merit of the interpretation.*" On page 15 of the opinion, the Court agreed with the Board's position that "*...annotations are not regulations, and they are not binding upon taxpayers, the Board itself, or the Court. Nevertheless, the annotations are digests of opinions written by the legal staff of the Board which are evidentiary of administrative interpretations made by the Board in the normal course of its administration of the Sales and Use Tax Law.*"

Proper Use of Annotations – Discussion of Current Application

On August 6, 1998, the Program Planning Manager issued a memorandum to District Administrators reminding Sales and Use Tax Department staff of the correct use of annotations. The memorandum included the advisory statement from the M98-3 edition of the Business Taxes Law Guide:

Business Taxes Annotations are synopses of legal opinions. Annotations are intended to provide guidance regarding the interpretation of Board statutes and regulations as applied by staff to specific factual situations. Annotations are not regulations of the Board and do not have the force or effect of law. Although annotations are synopses of past advice provided by Board's legal staff, the advice is not binding and may be revised at any time. The date appearing at the end of an annotation reflects the agency's interpretation of statutes existing as of that date. Due to delays resulting from the process of adding, amending, or deleting annotations, an annotation may remain in the Law Guide even though subsequent legislative or administrative action may have invalidated the advice provided in the annotation. In any instance where there is an inconsistency between the statute and an annotation, statutory law is controlling.

Following the advice provided in an annotation is not reasonable reliance upon written advice for purposes of obtaining relief from a failure to pay tax, interest, and penalty.

Publication of Annotations – Discussion of Current Procedures

New annotations are initiated with the review of all correspondence produced by the Board's Legal Division by the Annotation Coordinator. In the case of property taxes, the Legal Division can also select opinions for annotation. Opinions suitable for annotation include:

- A legal opinion regarding an unusual transaction.
- A legal opinion which addresses a fact pattern that has not previously been the subject of an annotation.
- A legal opinion which further explains provisions of the law and regulations.
- A legal opinion which would be of interest to a large segment of the public.
- A legal opinion about new matters of broad application that have not previously been addressed by regulations or annotations.
- A legal opinion which is of statewide interest in the uniform administration of the property tax.

Opinions not suitable for annotation include.

- An opinion previously covered by another annotation or regulation.
- An opinion not interpretive of the Sales and Use Tax, Special Taxes, or Property Tax Laws.
- An opinion subject to Attorney-Client Privilege.
- An opinion written by other than legal counsel.

Opinions initially determined not suitable for annotation by the Annotation Coordinator, based on the criteria above, are reviewed by management. If management concurs, the opinion is not annotated. However, management may request the Annotation Coordinator reconsider their position if they believe the opinion is suitable for annotation. If the opinion is annotated, the process for the publication of a new annotation discussed below will be followed.

Legal opinions suitable for annotation are annotated and distributed to Board management and designated Legal Division staff for review and approval. Revisions and/or deletion of existing annotations, which generally commence with a recommendation from the Legal Division staff or the public, follow the same review and approval process as a new annotation.

Once approved, the newly proposed annotations and/or suggested revisions or deletion of existing annotations are published in a Current Legal Digest (CLD). CLDs are circulated for a thirty (30) day period to interested parties and Board staff, during which time any questions are addressed and/or suggested modifications are taken into consideration. After approval of the final version of the annotation by the Legal Division, it is printed in the Business Taxes or Property Taxes Law Guides.

Discussion of Operations Memorandum versus New Regulation

As stated previously, Cal-Tax recommended staff reconsider its position in setting forth policies for the establishment and use of annotations in an Operations Memorandum. Cal-Tax believes staff's proposal to address annotation policy in an Operations Memorandum is based on the view that the issue relates largely to internal Board procedures. Cal-Tax agrees parts of staff's proposed Operations Memorandum are best suited for an Operations Memorandum. However, they believe the goal should be to provide taxpayers, as well as staff, with notice and guidelines on the proper use and reliance on annotations. Additionally, Cal-Tax believes that an Operations Memorandum does not "provide taxpayers with any degree of assurance that the rules will be adhered to on a consistent basis. This is true for the following reasons:"

- "The Board likely would not even be permitted to approve an Operations Memorandum (such an action by the Board would constitute an underground regulation). Taxpayers too would be taken out of the process. This entire exercise becomes somewhat pointless if the resulting document is entirely within the control of the staff.
- "Operations Memorandum do not bind the entire staff. It is not entirely clear whether they are binding at all.
- "Operations Memo can be changed without prior authorization of the Board, notice to the Board or the public, and without any opportunity for the public to comment on the merits of the subsequent changes."

Cal-Tax believes a regulation addresses each of above concerns as regulations have

1. the authority to bind both taxpayers and staff,
2. will serve as a durable representation of the policies of the Board with respect to the proper use and publication of annotations, and
3. may not be altered without the Board's consent or absence of notice and opportunity to comment by taxpayers.

Cal-Tax also believes the authority to adopt this regulation exists just as the authority exists for the Board to adopt any other rules of practice and procedure.

Furthermore, Cal-Tax believes that too many taxpayers assume that the annotations are some form of developed administrative law. They point out that many taxpayers are unaware of the existence of the back-up documents which form the basis for the annotations. Additionally, they state a regulation would serve to provide a more durable standard of conduct for both taxpayers and the Board in the application, development and use of the annotations.

Staff initially recommended that procedures be set forth in an Operation Memorandum addressing the publication, depublication and proper use of annotations. Staff believed it inappropriate for the Board to adopt rules applicable to employee conduct (internal management of the state agency) as a regulation. Regulations have the force and effect of law. Violation of any provision of the Sales and Use Tax Law is a misdemeanor (R&TC §7153). Staff believes employee malfeasance should remain a management and employee discipline issue, and not become a criminal act.

Furthermore, the term “regulation” is defined in Government Code section 11342(g) to include a standard of general application adopted by any state agency to implement, interpret, or make specific the law enforced or administered by it, or to conform its procedure, “except one that relates only to the internal management of the state agency.”

After further consideration, staff now believes a new regulation should be adopted under the Rules of Practice providing the definition of an annotation and other related terms, and setting forth the use of annotations, the elements of annotated legal rulings of counsel, publication of an annotation and copies of legal ruling of counsel (Attachment 1). However, staff still believes that rules applicable to employee conduct, staff procedures for publication of annotations, timeframes for the publication of annotations, and annotation addition and deletion indices, are more appropriately placed in an Operations Memorandum (Attachment 3) with its provisions incorporated into the Board of Equalization Administrative Manual (BEAM).

Industry A agrees with staff’s proposed regulatory language.

Discussion of the Definition of “Annotation” and Proper Use of Annotations

In response to staff’s May 20, 1999, originally proposed draft of Operations Memorandum, *Annotations*, Mr. Mark Prescott submitted proposed modifications to the definition of an annotation and written directives under the proper use of annotations (Attachment 5).

Mr. Prescott’s believes the definition of an annotation and the proper use of annotations should incorporate the Supreme Court of California opinion in the

Yamaha decision. Staff and Industry A believe the proposed language should reflect the treatment of annotations at an administrative level rather than at the level of the courts.

Mr. Prescott believes a taxpayer has a right to know the law and its interpretation and requirements. Mr. Prescott also believes language should be incorporated into staff's proposed language, whether adopted as an Operations Memorandum or new regulation, requiring the disclosure of the definition and proper use of an annotation when a written copy of an annotation is provided to a taxpayer.

Staff agrees with Mr. Prescott that a taxpayer should be aware of the definition of an annotation and its proper use, and that reliance on an annotation would only constitute an excusable delay or reliance on written advice as provided in Regulation 1705. Accordingly, staff incorporated language into the proposed Operations Memorandum stating that copies of annotations provided to any person must be accompanied by the following statement:

“Annotations are synopses of legal opinions. Annotations are intended to provide guidance regarding the interpretation of Board statutes and regulations as applied by staff to specific factual situations. Annotations are not regulations of the board and do not have the force or effect of law. Although annotations are synopses of past advice provided by Board's legal staff, the advice is not binding and may be revised at any time. Following the advice provided in an annotation is not reasonable reliance upon written advice for purposes of obtaining relief from a failure to pay tax, interest, and penalty.”

With respect to a taxpayer's right to know the law and its interpretation and requirements, two of the goals of the State Board of Equalization are to (1) educate and assist tax- and feepayers to comply voluntarily and (2) provide high-quality customer service. The Board is committed to efficient and responsive taxpayer services which helps ensure that all types of businesses have the information they need to properly comply with California's complex and changing tax laws. In order to meet the needs of taxpayers, the Board offers the 800 number information center, an Internet web site, sales and use tax seminars, small business fairs, publications and newsletters, laws and regulations, and special notices. Accordingly, staff believes the Board offers a variety of services to educate taxpayers so they can properly comply with the taxes and fees it administers.

Discussion – Existing Annotations

Industry believes there may be existing annotations based on legal opinions that do not meet the criteria required to be considered a “legal ruling of counsel.” They also believe an honest assessment of the Board's longstanding position in this situation is critical for matters of due process of law and fair/objective administration of the tax programs.

Cal-Tax recognized having the Board update all of the nearly seven thousand (7,000) back-up documents to meet the standards of a legal ruling of counsel would be too burdensome on staff workload in the short term. Cal-Tax believes, however, that a procedure be adopted which will ensure the systematic review and update of all back-up documents to ensure they meet the standard for substantive analysis.

Staff agrees with Cal-Tax's proposal to adopt a procedure to ensure the systematic review and update of all existing annotation back-up documents. Staff proposes the review of annotation back-up documents as they are requested by the public and staff, and the removal from publication of any that do not qualify as a "legal ruling of counsel." Additionally, staff agrees to develop for management consideration a formal systematic review and update policy.

Discussion – Annotation Back-Up Documents

Industry believes that annotation back-up documents are not readily available for public or staff inspection. They believe that only when the underlying legal analysis is available will annotations truly serve to create consistency in the staff's application of the law, as well as provide some basis for educating taxpayers. Accordingly, industry recommends the Board initiate a program to make all back-up documents easily accessible to the public. Industry suggested, as an example, placing all back-up documents on the Board's Internet web site.

Although the Legal Division provides copies of annotation back-up documents to the public and staff with a turn-around time of no longer than two weeks, staff agrees with industry that the annotation back-up documents should be made readily available.

Staff agrees with industry's suggestion of placing the back-up documents on the Board's Internet web site. However, to do so would require that they be converted to digital format. Out of the six thousand eight hundred and eighteen (6,818) annotations published in the Business Taxes Law Guide, only approximately three hundred (300) back-up documents are in digital format. Accordingly, back-up documents to six thousand five hundred (6,500) annotations would need to be converted, either by retyping or scanning, to digital format.

Staff has found that the Board's Legal Division receives roughly thirty-five (35) back-up document requests a month for Business Taxes annotations. Based on the volume of requests, staff recommends initiating a fax-back service to respond to requests for back-up documents and that requests be satisfied no later than the next business day, absent a large volume of requests received on a single day or other unusual circumstances. If implemented, the public and staff will be notified of the fax-back service in the Board's Law Guides, on the Board's Internet web site, and in other appropriate publications.

Cal-Tax does not object to staff's proposed fax-back service. However, Cal-Tax believes that the Board should commit to developing a process to ensure all newly

developed or newly modified annotations, and back-up documents, be made available on the Board's Internet web site. Staff agrees such a procedure would better serve the public and staff. Accordingly, staff will work with the Legal Division to establish such a procedure on a prospective basis.

An issue regarding the condition and quality of back-up documents was also raised by industry. Recently, staff reviewed all Business Taxes annotation back-up documents for condition and to determine if any back-up documents were missing. Staff was unable to locate back-up documents for ninety-three (93) Business Taxes annotations. As a result, these annotations were deleted in the M99-1 edition of the Business Taxes Law Guide. Back-up documents for approximately three hundred (300) Business Taxes annotations were considered poor quality as they were difficult to read. The back-up documents to these three hundred (300) annotations were retyped by staff and are currently under review for typing accuracy and extraction of confidential information. The retyped back-up documents will be provided to a requesting party along with the original back-up documents. A review by staff confirmed that all Property Taxes annotations have backup documents.

Discussion – Challenging Annotations

Industry believes a procedure should be established whereby taxpayers, industry and representatives could challenge annotations before the Board when an annotation appears to be in error, without having to wait for an audit to raise the issue. Industry believes such a procedure is needed because inapplicable or erroneous annotations are relied upon at times by staff attorneys, which result in negative written opinions in reply to taxpayer questions. Industry states that currently such taxpayers have to wait until their issues are contested in an audit before the issue and annotation can be presented to the Board for consideration. This is unduly burdensome on taxpayers who need to make business decisions in real time since such decisions can have costly consequences.

Annotations are reviewed for accuracy on a continual basis by staff and will continue to be updated to add new interpretations and to remove conflicting and/or changed interpretations. Although staff is directed to notify the appropriate Department Chief or Manager³ if they believe an annotation is in error, a similar procedure has not been established for the public. If a public inquiry is received by the Board, there is a possibility it may not be handled in the identical manner as a staff inquiry. Accordingly, staff agrees a procedure should be developed to notify the public that an annotation may be challenged if believed to be in error or in conflict with applicable laws, regulations, or other annotations. This procedure would establish consistency between how staff and public annotation inquiries are handled. The procedure is included in staff's proposed regulatory language under section (e), Request for Depublication of an Annotation.

³ The Program Planning Manager for Sales and Use Taxes, the Program Planning and Evaluation Division Chief for Special Taxes, or the Policy, Planning and Standards Division Chief for Property Taxes.

Staff proposes that requests to delete an annotation believed to be in error or conflict with applicable laws, regulations, or other annotations be directed to the Chief Counsel. Any request for an annotation to be removed from the appropriate Law Guide shall be approved or denied by the Chief Counsel within sixty (60) days from the date the request is received by the Chief Counsel. If a request for the removal of an annotation is approved by the Chief Counsel, the Board will publish the proposed deletion in a Current Legal Digest. If a request for the removal of an annotation is denied, the requestor may bring the request before the Business Taxes or Property Taxes Committee for consideration.

Industry has also requested procedures for removing published annotations from Law Guides if:

- the elected Board has taken a position contrary to the staff's position which is published as an annotation,
- positions found in the annotations have gone to court and the court has found in favor of the taxpayer, contrary to the staff's annotated position, or
- staff's position in court is based upon an annotation, and the staff and the taxpayer decide to settle the case (court settlement).

Board opinions are published in the Business Taxes Law Guide as Memorandum of Opinion if directed by the Board Members, and are not annotated. However, Board opinions are taken into consideration by the Legal Division and/or department staff for possible revision to existing annotations.

Staff believes the above discussion on "Challenging Annotations" provides a procedure for taxpayers or other parties to request the removal of any annotation believed to be inconsistent or in conflict with a court decision or Board opinion.

Discussion – Joint Development of Annotations

Industry has proposed establishing a procedure whereby taxpayers, industries, and representatives could work together with Board staff to jointly develop annotations in new or emerging areas.

Staff believes it is inappropriate for staff to jointly develop annotations with taxpayers, industries, and representatives. Industry's proposal to jointly develop an annotation would require the joint development of a "legal ruling of counsel," that serves as the basis of an annotation. A "legal ruling of counsel" is defined as a legal opinion written and signed by the Chief Counsel or an attorney who is the Chief Counsel's designee, addressing a specific tax application inquiry from a taxpayer or taxpayer representative, a local government agency, or Board staff. If the Chief Counsel or an attorney who is the Chief Counsel's designee jointly developed an opinion with industry, the opinion would not qualify as a "legal ruling of counsel" and could not be annotated.

Staff determined in a subsequent discussion with the industry representative who submitted the proposal for the joint development of annotations that the specific concern dealt with annotations they believe have been misapplied by

Board staff. The resulting problem was that taxpayers were unable to challenge such annotations except through the audit appeal process. However, the representative has since agreed that staff's proposed depublication procedure, discussed above, would address his concern.

Discussion – Limiting Number of New Annotations Published

Industry had proposed limiting the number of annotations published annually, suggesting a limit of one hundred (100) annotations annually.

Staff estimates an average of two hundred and forty (240) new sales and use tax annotations, one hundred (100) new property tax annotations, and twenty-four (24) new special taxes annotations are published annually. Although staff believes the number of annotations published annually will decrease significantly based on the criteria required for annotations to be considered as legal rulings of counsel for annotation, industry's proposal to limit the number of new annotations published annually to one hundred is not practical. Staff believes limiting the number of annotations published annually to one hundred (100) for sales and use tax, fifty (50) for property taxes, and twenty (20) for special taxes, for a total of one hundred seventy (170) annotations, is reasonable. Staff's proposal will reduce the publication of sales and use tax annotations by fifty eight percent (58%), property taxes annotations by fifty percent (50%), and special taxes annotations by twenty percent (20%). As a result of recent discussions, industry has agreed with staff's proposal.

Discussion – Proposed Revisions to Regulation 1705, Relief from Penalty

Staff's proposed revisions to Regulation 1705 adds language that allows reliance by any person on an annotation or legal ruling of counsel to constitute an excusable delay or reliance on written advice only if: (1) the underlying legal ruling of counsel involving the fact pattern at issue is addressed to the person or to his or her representative under the conditions set forth in subdivision 1705(b); or (2) the annotation or legal ruling of counsel is provided to the person or his or her representative by the Board within the body of a written communication and involves the same fact pattern as that presented in the subject annotation or legal ruling of counsel. Industry agrees with staff's proposed regulatory language.

Additionally, industry requested trade or industry association members qualify for relief under this regulation if an association requests written advice on behalf of its members.

Regulation 1705 is based upon section 6596 of the Revenue and Taxation Code, "Excusable Delay – Reliance on Advice." Section 6596 provides in subsection (d) that "only the person making the written request shall be entitled to rely on the Board's written advice to that person." Accordingly, to rely on the Board's written advice, an "association", which includes both the association and its member(s) for purposes of subdivision (d) of staff's proposed revisions to Regulation 1705, is required to be identified.

Accordingly, staff proposed language to incorporate subdivision (e) stating the following:

“A trade or industry association requesting advice on behalf of its member(s) must identify and include the specific member name(s) for whom the advice is requested for relief from liability under this regulation.”

Industry agrees with staff's proposed regulatory language.

V. Staff Recommendation

A. Description of Staff's Recommendation

It is the staff's recommendation that procedures be set forth in a new regulation under the Rules of Practice addressing the publication, depublication and proper use of annotations; and Regulation 1705, *Relief From Liability*, be amended to add subsection (d) to discuss what constitutes reliance on written advice with respect to an annotation and subsection (e) to allow trade or industry association members to qualify for relief under this regulation if an association requests written advice on behalf of its members.

B. Pros of the Staff Recommendation

- A regulation is more accessible to the public.
- A regulation will serve as a durable representation of policies of the Board with respect to the proper use and publication of annotations.
- A regulation may not be altered without the Board's consent or absence of notice and opportunity to comment by taxpayers.
- Internal Board policy and procedural matters would be incorporated in an Operations Memorandum. Therefore, a basis would not be provided to criminally discipline employees of the Board for engaging in certain conduct. If an employee unknowingly violates the provisions provided in the Operations Memorandum, the result would not be a misdemeanor.

C. Cons of the Staff Recommendation

- Contrary to Industry B's proposal.

D. Statutory or Regulatory Change

Requires amendment to Regulation 1705.

E. Administrative Impact

Other than the normal regulatory process, no impact on staff.

F. Fiscal Impact

1. Cost Impact

Cost would be minimal and absorbable.

2. Revenue Impact

None

G. Taxpayer/Customer Impact

Minimal impact. New regulation will provide additional clarification.

H. Critical Time Frames

None

VI. Alternative 1

A. Description of Alternative 1

Adopt a new regulation under the Rules of Practice addressing the publication, depublishing and proper use of annotations that incorporates language proposed by Industry B to define the term "Annotation" and set forth the proper use of annotations based upon the California Supreme Court's interpretation of the treatment of annotations; and amend Regulation 1705, *Relief From Liability*, to add subsection (d) to discuss what constitutes reliance on written advice with respect to an annotation and subsection (e) to allow trade or industry association members to qualify for relief under this regulation if an association requests written advice on behalf of its members.

B. Pros of Alternative 1

- Informs the public of the treatment of annotation as interpreted by the California Supreme Court.

C. Cons of Alternative 1

- Reflects the treatment of annotations as interpreted by the California Supreme Court rather than at an administrative level.

D. Statutory or Regulatory Change

Requires amendment to Regulation 1705.

E. Administrative Impact

Other than the normal regulatory process, no impact on staff.

F. Fiscal Impact

1. Cost Impact

Cost would be minimal and absorbable.

2. Revenue Impact

None

G. Taxpayer/Customer Impact

Minimal impact. The new regulation will provide the court's interpretation of the treatment of annotations.

H. Critical Time Frames

None

Prepared by: Program Planning Division, Sales and Use Tax Department

Current as of: 06/18/1999.

Regulation 5200 — Annotations
Analysis of Proposed Staff and Industry Language

Action Item	Staff and Industry A's Proposed Regulatory Language	Industry B's Proposed Regulatory Language	Summary of Positions
Action 2 “Definition of an Annotation”	<p>(a) Definitions</p> <p>For purposes of this regulation, the following definitions shall apply:</p> <p>(1) “Annotations” that are published in either the Business Taxes Law Guide or the Property Taxes Law Guide are summaries of the conclusions reached in selected legal rulings of counsel.</p>	<p>(a) Definitions</p> <p>For purposes of this regulation, the following definitions shall apply:</p> <p>(1) <i>“Annotations” are mere summaries of conclusions reached in legal rulings of counsel that are published as annotations in either the Business Taxes Law Guide or the Property Taxes Law Guide. An annotation is an agency’s interpretation of the meaning and legal effect of a statute or regulation.</i></p>	<p>Industry B’s proposed regulatory language (submitted by Mr. Mark Prescott) is based on staff’s May 20, 1999 proposed Operations Memorandum with the incorporation of the California Supreme Court’s opinion of the definition of an annotation. Industry B believes “it is critical for taxpayers and Board auditors to understand the Supreme Court’s definition of an annotation to promote a clear understanding of what an annotation is.”</p> <p>Staff believes the proposed language should reflect the treatment of annotations at an administrative level rather than as they are interpreted by the court.</p>
Consent Item#1– “Definitions”	<p>(2) “Legal ruling of counsel” means a legal opinion written and signed by the Chief Counsel or an attorney who is the Chief Counsel’s designee, addressing a specific tax application inquiry</p>	<p>(2) “Legal ruling of counsel” means a legal opinion written and signed by the Chief Counsel or an attorney who is the Chief Counsel’s designee, addressing a specific tax application inquiry</p>	<p>Staff and industry agree.</p>

Regulation 5200 — Annotations
Analysis of Proposed Staff and Industry Language

Action Item	Staff and Industry A's Proposed Regulatory Language	Industry B's Proposed Regulatory Language	Summary of Positions
	from a taxpayer or taxpayer representative, a local government agency, or board staff.	from a taxpayer or taxpayer representative, a local government agency, or board staff.	
	(3) “Current Legal Digest” means a publication containing drafts of new annotations proposed to be added, and/or annotations proposed to be amended or deleted in the Business Taxes Law Guide or Property Taxes Law Guide.	(3) “Current Legal Digest” means a publication containing drafts of new annotations proposed to be added, and/or annotations proposed to be amended or deleted in the Business Taxes Law Guide or Property Taxes Law Guide.	Staff and industry agree.
	(4) “Tax” means any tax, fee, surcharge, assessment, assessment review, or exemption program administered by the Board or any tax over which the Board has oversight or advisory responsibility.	(4) “Tax” means any tax, fee, surcharge, assessment, assessment review, or exemption program administered by the Board or any tax over which the Board has oversight or advisory responsibility.	Staff and industry agree.
	(5) “Taxpayer” means person liable for the payment of any tax as the term tax is defined above.	(5) “Taxpayer” means person liable for the payment of any tax as the term tax is defined above.	Staff and industry agree.
	(6) “Board” means the State Board of Equalization.	(6) “Board” means the State Board of Equalization.	Staff and industry agree.

Regulation 5200 — Annotations
Analysis of Proposed Staff and Industry Language

Action Item	Staff and Industry A's Proposed Regulatory Language	Industry B's Proposed Regulatory Language	Summary of Positions
Action 3- “Use of Annotations”	(b) Use of Annotations	(b) Use of Annotations	Staff and Industry A agree.
	<p>(1) Annotations provide notice of the existence of and conclusions reached in selected legal rulings of counsel regarding the application of the statutory law, regulatory law, or judicial opinions to a particular factual circumstance.</p> <p>(2) Annotations are a research tool to locate selected legal rulings of counsel.</p> <p>(3) Annotations and the legal rulings of counsel they summarize are not regulations, not considered authority for the application of law, and are not binding upon taxpayers, members of local government agencies, board staff, or the Board.</p>	<p><i>Annotations are intended to provide guidance to both taxpayers and Board staff regarding the interpretation of statutes and regulations and are not binding on the Board itself, taxpayers, or local government officials. The binding power of an agency’s interpretation of a statute or regulation is contextual: Its power to persuade is both circumstantial and dependent on the presence or absence of factors that support the merit of the interpretation. The ultimate interpretation of a statute is an exercise of the judicial power. Where the meaning and legal effect of a statute is the issue, an agency’s interpretation is one among several tools available to the court. Depending on the context, an annotation may be helpful, enlightening, even convincing. It may sometimes be of little worth. The weight of an annotation in a particular case will depend</i></p>	<p>Industry B’s proposed regulatory language is based on staff’s May 20, 1999 proposed Operations Memorandum with the incorporation of the California Supreme Court’s opinion of the proper use of an annotation. Industry B believes “Board auditors and taxpayers must clearly understand what the binding power of an annotation is. The Supreme Court of California has spoken in Yamaha, and Board auditors and taxpayers should be empowered with the knowledge with exactly what the court said. It is critical that the definitive guidance on the proper use of an annotation include the Supreme Court’s statements on the binding power of an annotation.”</p> <p>Staff believes the proposed language should reflect the treatment of annotations at an administrative level rather than as they are interpreted by the court.</p>

Regulation 5200 — Annotations
Analysis of Proposed Staff and Industry Language

Action Item	Staff and Industry A's Proposed Regulatory Language	Industry B's Proposed Regulatory Language	Summary of Positions
		<p><i>upon the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control.</i></p> <p><i>The taxpayer has a right to know the law and an agency's interpretation of the statutes and regulations. In order to assist taxpayers, who are seeking to be in conformity and compliance with the law, and request to know what the applicable law and its interpretations are, Board staff and auditors will provide the taxpayer with identification of the applicable statutes, regulations and annotations related to transactions the taxpayer is seeking to be in conformity and compliance. When providing taxpayers with the reference of an annotation or a written copy of an annotation, such</i></p>	<p>Two of the goals of the State Board of Equalization are to (1) educate and assist tax- and fee payers to comply voluntarily and (2) provide high-quality customer service. The Board is committed to efficient and responsive taxpayer services which helps ensure that business of all kinds have the information they need to properly comply with California's complex and changing tax laws. In order to meet the needs of taxpayers, the Board offers the 800 number information center, an Internet web site, sales and use tax seminars, small business fairs, publications and newsletters, laws and regulations, and special notices. Accordingly, staff believes that the Board offers a</p>

Regulation 5200 — Annotations
Analysis of Proposed Staff and Industry Language

Action Item	Staff and Industry A's Proposed Regulatory Language	Industry B's Proposed Regulatory Language	Summary of Positions
		<i>disclosure must be accompanied with an explanation of what an annotation is and the description of the proper use of an annotation.</i>	variety of services to educate taxpayers so they can properly comply with the taxes and fees it administers. Staff agrees when providing taxpayers with the reference of an annotation or a written copy of an annotation, such disclosure should be accompanied with a brief explanation of what an annotation is and the description of the proper use of an annotation. Accordingly, such language has been incorporated into staff's proposed Operations Memorandum (Attachment 3).
Consent Item #2 – “Elements of Legal Rulings of Counsel”	(c) Elements of Annotated Legal Rulings of Counsel A legal ruling of counsel that is annotated must include the following elements: (1) a summary of pertinent facts, (2) an analysis of the issue(s), (3) references to any applicable statutes, regulations, or case law, and (4) a conclusion supported by the analysis.	(c) Elements of Annotated Legal Rulings of Counsel A legal ruling of counsel that is annotated must include the following elements: (1) a summary of pertinent facts, (2) an analysis of the issue(s), (3) references to any applicable statutes, regulations, or case law, and (4) a conclusion supported by the analysis.	Staff and industry agree.

Regulation 5200 — Annotations
Analysis of Proposed Staff and Industry Language

Action Item	Staff and Industry A's Proposed Regulatory Language	Industry B's Proposed Regulatory Language	Summary of Positions
Consent Item #3 – “Publication of Annotations”	<p>(d) Publication of Annotations</p> <p>(1) Before new annotations are added, or existing annotations are amended or deleted, the Board shall publish the proposed changes in a Current Legal Digest and shall provide interested persons not less than 30 days to comment on and, if necessary, challenge the proposed changes.</p> <p>(2) Any person may request, and shall be entitled to receive, Current Legal Digests. Requests to be added to the mailing list to receive Current Legal Digests may be directed to the Board's Legal Division.</p>	<p>(d) Publication of Annotations</p> <p>(1) Before new annotations are added, or existing annotations are amended or deleted, the Board shall publish the proposed changes in a Current Legal Digest and shall provide interested persons not less than 30 days to comment on and, if necessary, challenge the proposed changes.</p> <p>(2) Any person may request, and shall be entitled to receive, Current Legal Digests. Requests to be added to the mailing list to receive Current Legal Digests may be directed to the Board's Legal Division.</p>	Staff and industry agree.
Consent Item #4 – “De-publication of Annotations”	<p>(e) Request for Depublication of an Annotation</p> <p>An annotation published in the Business Taxes Law Guide or the Property Taxes Law Guide believed to be in error and/or appearing to conflict with another annotation may be depublished using the following procedure:</p>	<p>(e) Request for Depublication of an Annotation</p> <p>An annotation published in the Business Taxes Law Guide or the Property Taxes Law Guide believed to be in error and/or appearing to conflict with another annotation may be depublished using the following procedure:</p>	Staff and industry agree.

Regulation 5200 — Annotations
Analysis of Proposed Staff and Industry Language

Action Item	Staff and Industry A's Proposed Regulatory Language	Industry B's Proposed Regulatory Language	Summary of Positions
	<p>(1) A request for depublication of an annotation shall be directed to the Chief Counsel.</p> <p>(2) A request for depublication of an annotation shall be approved or denied by the Chief Counsel within sixty (60) days from the date the request is received.</p> <p>(3) If a request for the depublication of an annotation is approved by the Chief Counsel, the Board shall publish the proposed depublication in a Current Legal Digest.</p> <p>(4) If a request for the depublication of an annotation is denied, the requestor may bring the request before the Board's Business Taxes or Property Taxes Committee for consideration.</p>	<p>(1) A request for depublication of an annotation shall be directed to the Chief Counsel.</p> <p>(2) A request for depublication of an annotation shall be approved or denied by the Chief Counsel within sixty (60) days from the date the request is received.</p> <p>(3) If a request for the depublication of an annotation is approved by the Chief Counsel, the Board shall publish the proposed depublication in a Current Legal Digest.</p> <p>(4) If a request for the depublication of an annotation is denied, the requestor may bring the request before the Board's Business Taxes or Property Taxes Committee for consideration.</p>	

[illegible]

Regulation 1705 — Relief from Liability
Analysis of Staff and Industry Proposed Language

Action Item	Current Regulatory Language	Staff and Industry's Proposed Regulatory Language	Summary Comments
Consent Item #6 – Regulation 1705	(a) In General. A person may be relieved from the liability for the payment of sales and use taxes, including any penalties and interest added to those taxes, when that liability resulted from the failure to make a timely return or a payment and such failure was found by the Board to be due to reasonable reliance on:	(a) In General. A person may be relieved from the liability for the payment of sales and use taxes, including any penalties and interest added to those taxes, when that liability resulted from the failure to make a timely return or a payment and such failure was found by the Board to be due to reasonable reliance on:	No change to existing regulation.
	(1) written advice given by the Board under the conditions set forth in subdivision (b) below, or	(1) written advice given by the Board under the conditions set forth in subdivision (b) below, or	No change to existing regulation.
		<u>(2) written advice in the form of an annotation or legal ruling of counsel under the conditions set forth in subdivision (d) below, or</u>	Staff accepts industry's proposed language and has made the necessary revisions.
	(2) written advice given by the Board in a prior audit of that person under the conditions set forth in subdivision (c) below. As used in this regulation, the term "prior audit" means any audit conducted prior to the current examination where the issue in question was examined.	(2) (3) written advice given by the Board in a prior audit of that person under the conditions set forth in subdivision (c) below. As used in this regulation, the term "prior audit" means any audit conducted prior to the current examination where the issue in question was examined.	Other than re-numbering the subdivision, no change to existing regulation language.

Regulation 1705 — Relief from Liability
Analysis of Staff and Industry Proposed Language

Action Item	Current Regulatory Language	Staff and Industry's Proposed Regulatory Language	Summary Comments
	Written advice from the Board may only be relied upon by the person to whom it was originally issued or a legal or statutory successor to that person. Written advice from the Board which was received during a prior audit of the person under the conditions set forth in subdivision (c) below, may be relied upon by the person audited or by a legal or statutory successor to that person. The term “written advice” includes advice that was incorrect at the time it was issued as well as advice that was correct at the time it was issued, but, subsequent to issuance, was invalidated by a change in statutory or constitutional law, by a change in Board regulations, or by a final decision of a court of competent jurisdiction. Prior written advice may not be relied upon subsequent to: (1) the effective date of a change in statutory or constitutional law and Board regulations or the date of a final decision of a court of competent	Written advice from the Board may only be relied upon by the person to whom it was originally issued or a legal or statutory successor to that person. Written advice from the Board which was received during a prior audit of the person under the conditions set forth in subdivision (c) below, may be relied upon by the person audited or by a legal or statutory successor to that person. The term “written advice” includes advice that was incorrect at the time it was issued as well as advice that was correct at the time it was issued, but, subsequent to issuance, was invalidated by a change in statutory or constitutional law, by a change in Board regulations, or by a final decision of a court of competent jurisdiction. Prior written advice may not be relied upon subsequent to: (1) the effective date of a change in statutory or constitutional law and Board regulations or the date of a final decision of a	No change to existing regulation.

Regulation 1705 — Relief from Liability
Analysis of Staff and Industry Proposed Language

Action Item	Current Regulatory Language	Staff and Industry's Proposed Regulatory Language	Summary Comments
	<p>jurisdiction regardless that the Board did not provide notice of such action; or (2) the person receiving a subsequent writing notifying the person that the advice was not valid at the time it was issued or was subsequently rendered invalid. As generally used in this regulation, the term “written advice” includes both written advice provided in a written communication under subdivision (b) below and written advice provided in a prior audit of the person under subdivision (c) below.</p>	<p>court of competent jurisdiction regardless that the Board did not provide notice of such action; or (2) the person receiving a subsequent writing notifying the person that the advice was not valid at the time it was issued or was subsequently rendered invalid. As generally used in this regulation, the term “written advice” includes both written advice provided in a written communication under subdivision (b) below and written advice provided in a prior audit of the person under subdivision (c) below.</p>	
	<p>(b) Advice Provided in a Written Communication. Advice from the Board provided to the person in a written communication must have been in response to a specific written inquiry from the person seeking relief from liability, or from his or her representative. To be considered a specific written inquiry for purposes of this regulation,</p>	<p>(b) Advice Provided in a Written Communication. Advice from the Board provided to the person in a written communication must have been in response to a specific written inquiry from the person seeking relief from liability, or from his or her representative. To be considered a specific written inquiry for purposes of this regulation,</p>	No change to existing regulation.

Regulation 1705 — Relief from Liability <i>Analysis of Staff and Industry Proposed Language</i>			
Action Item	Current Regulatory Language	Staff and Industry's Proposed Regulatory Language	Summary Comments
	<p>representatives must identify the specific person for whom the advice is requested. Such inquiry must have set forth and fully described the facts and circumstances of the activity or transactions for which the advice was requested.</p> <p>(c) Written Advice Provided in a Prior Audit. Presentation of the person's books and records for examination by an auditor shall be deemed to be a written request for the audit report. If a prior audit report of the person requesting relief contains written evidence which demonstrates that the issue in question was examined, either in a sample or census (actual) review, such evidence will be considered "written advice from the Board" for purposes of this regulation. A census (actual) review, as opposed to a sample review, involves examination of 100% of the person's transactions pertaining to the issue in question. For written advice contained in a prior audit</p>	<p>representatives must identify the specific person for whom the advice is requested. Such inquiry must have set forth and fully described the facts and circumstances of the activity or transactions for which the advice was requested.</p> <p>(c) Written Advice Provided in a Prior Audit. Presentation of the person's books and records for examination by an auditor shall be deemed to be a written request for the audit report. If a prior audit report of the person requesting relief contains written evidence which demonstrates that the issue in question was examined, either in a sample or census (actual) review, such evidence will be considered "written advice from the Board" for purposes of this regulation. A census (actual) review, as opposed to a sample review, involves examination of 100% of the person's transactions pertaining to the issue in question. For written advice contained in a prior audit of the</p>	<p>No change to existing regulation.</p>

Regulation 1705 — Relief from Liability
Analysis of Staff and Industry Proposed Language

Action Item	Current Regulatory Language	Staff and Industry's Proposed Regulatory Language	Summary Comments
	<p>of the person to apply to the person's activity or transaction in question, the facts and conditions relating to the activity or transaction must not have changed from those which occurred during the period of operation in the prior audit. Audit comments, schedules, and other writings prepared by the Board that become part of the audit work papers which reflect that the activity or transaction in question was properly reported and no amount was due are sufficient for a finding for relief from liability, unless it can be shown that the person seeking relief knew such advice was erroneous.</p>	<p>person to apply to the person's activity or transaction in question, the facts and conditions relating to the activity or transaction must not have changed from those which occurred during the period of operation in the prior audit. Audit comments, schedules, and other writings prepared by the Board that become part of the audit work papers which reflect that the activity or transaction in question was properly reported and no amount was due are sufficient for a finding for relief from liability, unless it can be shown that the person seeking relief knew such advice was erroneous.</p> <p><u>(d) Annotations and Legal Rulings of Counsel. Advice from the Board provided to the person in the form of an annotation or legal ruling of counsel shall constitute written advice only if:</u></p> <p><u>(1) the underlying legal ruling of counsel involving the fact pattern at issue is addressed to</u></p>	<p></p> <p>Staff believes the term "person" should be used for consistency throughout the regulation.</p> <p>Industry agrees with staff's proposed regulatory language.</p>

Regulation 1705 — Relief from Liability
Analysis of Staff and Industry Proposed Language

Action Item	Current Regulatory Language	Staff and Industry's Proposed Regulatory Language	Summary Comments
		<p><u>the person or to his or her representative under the conditions set forth in subdivision (b) above; or</u></p> <p><u>(2) the annotation or legal ruling of counsel is provided to the person or his or her representative by the Board within the body of a written communication and involves the same fact pattern as that presented in the subject annotation or legal ruling of counsel.</u></p> <p><u>(e) Trade or Industry Associations. A trade or industry association requesting advice on behalf of its member(s) must identify and include the specific member name(s) for whom the advice is requested for relief from liability under this regulation.</u></p>	<p>Industry requested that trade or industry association members qualify for relief under this regulation if an association requests written advice on behalf of its members. Staff agrees with this concept provided that names of the members are provided with the written request.</p> <p>Industry agrees with staff's proposed regulatory language.</p>

State Board of Equalization
OPERATIONS MEMO
(For public release)

No: XXXX
Date: XXXX

Subject: Annotations

I. Definitions

“Annotations” published in either the Business Taxes Law Guide or the Property Taxes Law Guide are summaries of the conclusions reached in selected legal rulings of counsel.

A “legal ruling of counsel” means a legal opinion written and signed by the Chief Counsel or an attorney who is the Chief Counsel’s designee, addressing a specific tax application inquiry from a taxpayer or taxpayer representative, a local government agency, or board staff.

“Current Legal Digest” means a publication containing drafts of new annotations proposed to be added, and/or annotations proposed to be amended or deleted in the Business Taxes Law Guide or Property Taxes Law Guide.

“Tax” means any tax, fee, surcharge, assessment, assessment review, or exemption program administered by the Board or any tax over which the Board has oversight or advisory responsibility.

“Taxpayer” means a person liable for the payment of any tax as the term tax is defined above.

“Board” means the State Board of Equalization.

II. Use of Annotations

A transaction is or is not taxable based on the statutes and regulations, not on the existence or nonexistence of an annotation. Annotations are not to be used by Board staff as authority to assert or not assert tax against a taxpayer, unless the underlying legal ruling of counsel was written in direct response to a request involving the taxpayer at issue.

Copies of an annotation provided to any person must be accompanied by the following statement:

“Annotations are synopses of legal opinions. Annotations are intended to provide guidance regarding the interpretation of Board statutes and regulations as applied by staff to specific factual situations. Annotations are not regulations of the board and do not have the force or effect of law. Although annotations are synopses of past advice provided by Board’s legal staff, the advice is not binding and may be revised at any time. Following the advice provided in an annotation is not reasonable reliance upon written advice for purposes of obtaining relief from a failure to pay tax, interest, and penalty.”

III. Publication of Annotations

A. General

No annotation or substantive amendment to an annotation shall be published in the Business Taxes Law Guide or the Property Taxes Law Guide unless there is a legal ruling of counsel supporting the annotation or amendment.

A legal ruling of counsel may be considered for annotation if it clearly meets the following criteria:

- A legal opinion regarding an unusual transaction; or
- A legal opinion that further explains provisions of statute(s) or regulation(s); or
- A legal opinion of interest to a large segment of the public; or
- A legal opinion addressing a fact pattern that has not previously been the subject of an annotation; or
- A legal opinion of statewide interest in the uniform administration of property tax law.

A legal ruling of counsel may not be annotated if it is:

- A legal opinion previously covered by another annotation or by regulation; or
- An opinion subject to the Attorney-Client Privilege; or
- An annotation that does not otherwise clearly meet the criteria specified above.

B. Timeframes for the Publication of Annotations

Before new annotations are added, or existing annotations are amended or deleted, the Board shall publish the proposed changes in a Current Legal Digest and shall provide interested parties not less than 30 days to comment on and, if necessary, challenge the proposed changes.

A new annotation shall not be published if it involves a taxpayer who has filed a petition for redetermination before the State Board of Equalization involving the subject of the legal ruling of counsel until a final determination on the petition has been made. A final determination on the petition has been made when all administrative appeal rights before the State Board of Equalization have been exhausted or when any further administrative appeal is no longer timely.

If an annotation of a legal ruling of counsel is not published in a Current Legal Digest within 180 days of the date of the legal ruling of counsel, the legal ruling of counsel may not be annotated. The 180-day limit does not include the period of time during which the Board is prohibited from publishing the annotation involving a taxpayer who has filed a petition for redetermination involving the subject of the legal ruling of counsel. In such cases, the 180-day limit commences once there is a final determination on the petition.

C. Format

Every annotation published by the Board shall include the date of the legal ruling of counsel upon which the annotation is based. Such date will appear at the end of the annotation. The date of the legal ruling of counsel reflects the agency's interpretation of statutes existing as of that date. The publication edition date and the publication edition date of any amendment to the annotation will also appear at the end of an annotation and be denoted by "Am" followed by the Law Guide edition (for example, M97-4, Am.98-3).

Due to delays resulting from the process of adding, amending or deleting annotations, an annotation may continue to be published in the Law Guide even though subsequent legislative or administrative action may have invalidated the advice provided in the annotation. In any instance where there is an inconsistency between the statute and an annotation, or a regulation and an annotation, the statute or regulation is controlling.

D. Additions and Deletions Indices

Annotation additions and deletion indices will be maintained in the Business Taxes Law Guide and Property Taxes Law Guide. The additions index indicates when annotations are added to the Business Taxes Law Guide or the Property Taxes Law Guide. The deletion index indicates when annotations are deleted from the Business Taxes Law Guide or the Property Taxes Law Guide. These two indices will be maintained under a separate tab at the end of the Annotations Section. Each of these indices shall be updated in every revision of the Business Taxes Law Guide or the Property Taxes Law Guide.

E. Staff Responsibilities

Annotations are reviewed for accuracy on a continual basis and will continue to be updated to add new interpretations and remove conflicting and/or changed interpretations. When a staff member believes an annotation is in error, further guidance should be sought from the appropriate Department Chief or Manager¹, who will, if necessary, consult with the Legal Division.

If there appears to be a conflict between annotations, the date of the opinion letter on which each annotation is based should be determined. Secondly, it should be determined whether there was a change in statutory, regulatory or case law between those dates. If so, it should be brought to the attention of the Annotation Coordinator so that staff can determine whether the superseded annotation should be deleted or a notation added. If the conflict is not due to a change in statutory, regulatory or case law and there is no difference in facts that explains the different results, staff should consult with their supervisor. If the apparent conflict remains unexplained, the Department Chief or Manager should be contacted. If appropriate, the Department Chief or Manager will bring the matter to the attention of the Legal Division and seek guidance.

VI. Requests for Annotation Backup Documents

Any person may request, and shall be entitled to receive, a copy of a legal ruling of counsel, with confidential taxpayer information excised, that has been annotated in the Business Taxes Law Guide or Property Taxes Law Guide. Requests may be directed to the Board's Legal Division or Board's fax-back service. Absent a large volume of requests received on a single business day, or other unusual circumstance, the Board will generally provide fax-back copies within one business day.

V. Destruction of District Libraries

Once a year, the Department Deputy Directors will send a memo to District Administrators or department supervisors reminding them that staff should not cite or rely on non-annotated opinions. District libraries should not include non-annotated opinions.

¹The Program Planning Manager for Sales and Use Taxes, the Program Planning and Evaluation Division Chief for Special Taxes, or the Policy, Planning and Standards Division Chief for Property Taxes.

VI. Applicability of Operations Memo

This Operations Memo will be applied on a prospective basis.

VII. Obsolescence

This operations memo will become obsolete when the necessary information has been incorporated into the BEAM.

J. E. Speed
Deputy Director
Sales and Use Tax Department

Dick Johnson
Deputy Director
Property Taxes Department

Allan K. Stuckey
Deputy Director
Special Taxes Department

Distribution: 1-D

Regulation 1705. Relief From Liability.

Reference: Section 6596, Revenue and Taxation Code.

(a) In General. A person may be relieved from the liability for the payment of sales and use taxes, including any penalties and interest added to those taxes, when that liability resulted from the failure to make a timely return or a payment and such failure was found by the Board to be due to reasonable reliance on:

(1) written advice given by the Board under the conditions set forth in subdivision (b) below, or

(2) written advice in the form of an annotation or legal ruling of counsel under the conditions set forth in subdivision (d) below, or

~~(23)~~ written advice given by the Board in a prior audit of that person under the conditions set forth in subdivision (c) below. As used in this regulation, the term “prior audit” means any audit conducted prior to the current examination where the issue in question was examined.

Written advice from the Board may only be relied upon by the person to whom it was originally issued or a legal or statutory successor to that person. Written advice from the Board which was received during a prior audit of the person under the conditions set forth in subdivision (c) below, may be relied upon by the person audited or by a legal or statutory successor to that person.

The term “written advice” includes advice that was incorrect at the time it was issued as well as advice that was correct at the time it was issued, but, subsequent to issuance, was invalidated by a change in statutory or constitutional law, by a change in Board regulations, or by a final decision of a court of competent jurisdiction. Prior written advice may not be relied upon subsequent to: (1) the effective date of a change in statutory or constitutional law and Board regulations or the date of a final decision of a court of competent jurisdiction regardless that the Board did not provide notice of such action; or (2) the person receiving a subsequent writing notifying the person that the advice was not valid at the time it was issued or was subsequently rendered invalid. As generally used in this regulation, the term “written advice” includes both written advice provided in a written communication under subdivision (b) below and written advice provided in a prior audit of the person under subdivision (c) below.

(b) Advice Provided in a Written Communication. Advice from the Board provided to the person in a written communication must have been in response to a specific written inquiry from the person seeking relief from liability, or from his or her representative. To be considered a specific written inquiry for purposes of this

regulation, representatives must identify the specific person for whom the advice is requested. Such inquiry must have set forth and fully described the facts and circumstances of the activity or transactions for which the advice was requested.

(c) Written Advice Provided in a Prior Audit. Presentation of the person's books and records for examination by an auditor shall be deemed to be a written request for the audit report. If a prior audit report of the person requesting relief contains written evidence which demonstrates that the issue in question was examined, either in a sample or census (actual) review, such evidence will be considered "written advice from the Board" for purposes of this regulation. A census (actual) review, as opposed to a sample review, involves examination of 100% of the person's transactions pertaining to the issue in question. For written advice contained in a prior audit of the person to apply to the person's activity or transaction in question, the facts and conditions relating to the activity or transaction must not have changed from those which occurred during the period of operation in the prior audit. Audit comments, schedules, and other writings prepared by the Board that become part of the audit work papers which reflect that the activity or transaction in question was properly reported and no amount was due are sufficient for a finding for relief from liability, unless it can be shown that the person seeking relief knew such advice was erroneous.

(d) Annotations and Legal Rulings of Counsel. Advice from the Board provided to the person in the form of an annotation or legal ruling of counsel shall constitute written advice only if:

(1) the underlying legal ruling of counsel involving the fact pattern at issue is addressed to the person or to his or her representative under the conditions set forth in subdivision (b) above; or

(2) the annotation or legal ruling of counsel is provided to the person or his or her representative by the Board within the body of a written communication and involves the same fact pattern as that presented in the subject annotation or legal ruling of counsel.

(e) Trade or Industry Associations. A trade or industry association requesting advice on behalf of its member(s) must identify and include the specific member name(s) for whom the advice is requested for relief from liability under this regulation.

History: Adopted August 1, 1997, effective November 9, 1997.

Subject. Annotations

I General

Annotations are mere summaries of conclusions reached in legal rulings of counsel that are published as annotations in either the Business Taxes Law Guide or the Property Taxes Law Guide. An annotation is an agency's interpretation of the meaning and legal effect of a statute or regulation.

II Proper Use of Annotations

Annotations are intended to provide guidance to both taxpayers and Board staff regarding the interpretation of statutes and regulations as applied by staff to specific factual situations. Annotations are not regulations and are not binding on the Board itself, taxpayers, or local government officials. The binding power of an agency's interpretation of a statute or regulation is contextual: Its power to persuade is both circumstantial and dependent on the presence or absence of factors that support the merit of the interpretation. The ultimate interpretation of a statute is an exercise of the judicial power. Where the meaning and legal effect of a statute is the issue, an agency's interpretation is one among several tools available to the court. Depending on the context, an annotation may be helpful, enlightening, even convincing. It may sometimes be of little worth. The weight of an annotation in a particular case will depend upon the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control.

A transaction is or is not taxable based on the statutes and regulations, not on the existence or nonexistence of an annotation. Annotations are not to be used by Board staff as authority to assert or not assert tax against a taxpayer, unless the underlying legal ruling of counsel was written in direct response to a request involving the taxpayer at issue or in response to a request involving the same fact pattern.

Annotations shall not be cited or considered authority for the application of the law. A legal ruling of counsel shall only be used as evidence of long standing administrative interpretation if the ruling conforms to the requirement of this section, was contemporaneously annotated and published in the applicable Law Guide.

The taxpayer has a right to know the law and an agency's interpretation of the statutes and Regulations. In order to assist taxpayers, who are seeking to be in conformity and compliance with the law, and request to know what the applicable law and its interpretations are, Board staff and auditors will provide the taxpayer with identification of the applicable statutes, regulations and annotations related to transactions the taxpayer is seeking to be in conformity and compliance. When providing taxpayers with the reference of an annotation or a written copy of an annotation, such disclosure must be accompanied with an explanation of what an annotation is (its definition -- Section 1. , above) and the description of the proper use of an annotation (described in the preceding three paragraphs of this Section II.).

Subject: Annotations

Introductory comments:

The following reasoning and perspective to our proposed modifications of the draft Operations Memo on Annotations represents the view of a taxpayer (business]. We appreciate the opportunity to participate in this process and submit our ideas on an area which we believe is very important in the fabric of our tax structure and the conformity and compliance with it. Attached is our proposed additions to the most recent draft of the Operation Memo on Annotations. Please note, if a regulation is determined to be the vehicle for the change, then we seek incorporating our suggested additions into the regulation.

Reasoning and comments:

We believe that under any tax system, the objectives of conformity and compliance with the tax law and its requirements are goals for both taxpayers and the agencies created to administer and enforce the tax laws.

In order for taxpayers to conform and comply to the tax law, taxpayers must know what the law, its interpretations, and requirements are. Taxpayers have a right to know the law and its interpretations. If they do not have that right, then they should not be held responsible for not conforming to the law. In order to deal with the thousands of taxpayer who exist, the only effective and equitable manner of communicating the law and its requirements and interpretations is in written format. Board staff and, more importantly, Board auditors should never keep the law, its interpretations, and requirements hidden from taxpayers. The Supreme Court stated in the Yamaha decision that "the agency has a comparative interpretive advantage over the courts". We state that the agency has enormous comparative knowledge advantage over the taxpayers. Since the goal of conformity and compliance applies to both the taxpayer and the Board itself, the playing field should be equal and the taxpayers should be afforded the right to know the law, its interpretations, and requirements in written format.

Annotations are very important tools in the fabric of the tax system. Annotations are written by senior agency officials who have the expertise and technical knowledge, especially where the legal text to be interpreted is technical, obscure, complex, open-ended, or entwined with issues of fact, policy, and discretion. A court is more likely to defer to an agency's interpretation of its own regulation than to its (an agency's) interpretation of a statute, since the agency is likely to be intimately familiar with regulations it authored and sensitive to the practical implications of one interpretation over another. Annotations can provide Board auditors with the necessary information of how the statutes and regulations are interpreted by the Board. At the same time, the taxpayer who has access and knowledge of the annotation can understand how the Board is interpreting a particular factual situation and may rely on that information to form a logical conclusion, that if he conforms and compiles his business affairs to the Board's interpretation of the meaning and legal effect of a statute or regulation, he will be in conformity and compliance with the law.

Attorney General Dan Lungren's statement that "the annotations have substantial presidential effect within the agency", to which the Supreme Court of California agreed, implies the expectation of consistent application of annotations by Board auditors. If a Board auditor is in disagreement with an annotation's conclusions or interpretations, then channels for repeal or change are open to employees at the Board, as they should be equally available to the taxpayers. As a practical matter, the taxpayer can place reliance on an annotation knowing that if he, the taxpayer, is in conformity and compliance with the Board's interpretation, he would assume that he is in conformity and compliance with the related statutes and regulations. In this situation, the Board and its auditors are bound to the Board's interpretation and the taxpayer may rely on that. Accordingly, in this instance, where a taxpayer is in conformity and compliance with a long-standing annotation, the auditor may not take a contrary position to the Board's interpretation but must seek to have the annotation changed or repealed prospectively through the aforementioned channels for repeal or change.

We believe that the proposed definition of an annotation and the definitive statements on the proper use of annotations in the Operations Memo (or proposed Regulation) must incorporate what the Supreme Court of California opinion says in the Yamaha decision. Accordingly, we propose the following modifications:

- (1.) The Supreme Court defines annotations as "an agency's interpretation of the meaning and legal effect of a statute or regulation." It is critical for taxpayers and Board auditors to understand this and must be included in the definition in order to promote clear understanding of what an annotation is.
- (2.) Board auditors and taxpayers must clearly understand what the binding power of an annotation is. The Supreme Court of California has spoken in Yamaha, and Board auditors and taxpayers should be empowered with the knowledge with exactly what the court said. It is critical that the definitive guidance on the proper use of an annotation include the Supreme Court's statements on the binding power of an annotation. We propose inclusion of the following:

"The binding power of an agency's interpretation of a statute or regulation is contextual: Its power to persuade is both circumstantial and dependent on the presence or absence of factors that support the merit of the interpretation. The ultimate interpretation of a statute is an exercise of the judicial power. Where the meaning and legal effect of a statute is the issue, an agency's interpretation is one among several tools available to the court. Depending on the context, an annotation may be helpful, enlightening, even convincing. It may sometimes be of little worth. The weight of an annotation in a particular case will depend upon the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control."

We believe that a taxpayer has a right to know the law and its interpretations and requirements. In a letter we received from the Taxpayers' Rights Advocate's Office in response to a legal question we posed, and confirmed by Gary Jugum in meeting of interested parties on annotations, on June 1, 1999, the Board's written and verbal position

to us is as follows: "While there is no 'right to written documentation which defines the audit supervisor's position,' it is the Board's policy to fully inform a taxpayer regarding the basis of any determination." As a taxpayer, we believe an audit supervisor's position includes and involves the application of the applicable statutes and regulations involved in transactions under audit. To take the position that a taxpayer has no right to written documentation of the law (the applicable statutes and regulations), applied by an audit supervisor, when requested by a taxpayer, prior to a determination (decision), seems to us to be a violation of the taxpayers fundamental rights to know the law and renders the Board's comparative knowledge advantage over the taxpayer even greater. In addition, we believe the taxpayer has a right to know the Board's interpretations (annotations) and should be provided with the knowledge of the annotation prior to determination, providing at the same time an explanation of the proper use and meaning of an annotation is provided the taxpayer, as we have proposed in the attached modified Operation Memo.

Knowledge empowers people to act in the light and not darkness. If we want to achieve the goals of conformity and compliance with the tax law and requirements, we must afford those responsible with the payment of taxes and those responsible with the administration and enforcement of tax law, with the knowledge of the law, its interpretations, and requirements. Accordingly, we propose inclusion of the following statement in the proper use of annotations:

'The taxpayer has a right to know the law and an agency's interpretation of the statutes and regulations. In order to assist taxpayers, who are seeking to be in conformity and compliance with the law, and request to know what the applicable law and its interpretations are, Board staff and auditors will provide the taxpayer with identification of the applicable statutes, regulations and annotations related to transactions the taxpayer is seeking to be in conformity and compliance. When providing taxpayers with the reference of an annotation or a written copy of an annotation, such disclosure must be accompanied with an explanation of what an annotation is (its definition -Section 1., above) and the description of the proper use of an annotation (described in the preceding three paragraphs of this Section II.).